United Nations E/C.18/2013/1

Economic and Social Council

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9 August 2013

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Committee of Experts on International Cooperation in Tax Matters
Ninth session
Geneva, 21-25 October 2013

Provisional agenda

1. Opening of the session by the representative of the Secretary-General.
2. Election of the Chair and other officers (closed meeting).
3. Consideration of the rules of procedure and other organizational issues (closed meeting).
4. Introductory remarks by the Chair of the Committee.
5. Adoption of the agenda and organization of work (E/C.18/2013/1 and E/C.18/2013/2).
6. Discussion of substantive issues related to international cooperation in tax matters:
   (a) Issues related to the updating of the United Nations Model Tax Convention (E/C.18/2013/3):
      (i) Article 4. Resident: application of treaty rules to hybrid entities (E/C.18/2013/CRP.1 and E/C.18/2012/CRP.7);
      (ii) Article 5. Permanent establishment:
         (a) Meaning of "connected projects" (E/C.18/2013/CRP.2);
         (b) Whether a satellite in geostationary orbit could constitute a permanent establishment;
         (c) Permanent establishment issues in international value added tax cases (E/C.18/2013/CRP.3);
      (iii) Article 7. Business profits: "force of attraction" and the consideration and explanation of its operation;
      (iv) Article 8. Shipping, inland waterways transport and air transport: meaning and coverage of the term "auxiliary activities" (E/C.18/2013/CRP.4);

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(v) Article 9. Associated enterprises: update of its commentary (E/C.18/2013/4);

(vi) Article 12. Royalties: general consideration, including equipment-related issues;

(vii) Article 13. Capital gains: the practical implications of paragraph 4;

(viii) Article 23. Methods for the elimination of double taxation: conflicts of qualification and conflicts of interpretation in 2012 in the context of the discussion on climate change;

(ix) Article 26. Exchange of information;

(x) Various articles: taxation of services and the provision on taxation of fees for technical services (E/C.18/2013/CRP.5);

(xi) Various articles: United Nations Model Tax Convention and climate change mechanisms (E/C.18/2013/CRP.6).

(b) Other issues:

(i) Issues for the next update of the United Nations Practical Manual on Transfer Pricing for Developing Countries (E/C.18/2013/4 and E/C.18/2013/CRP.15);

(ii) Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries (E/C.18/2013/CRP.7-12);

(iii) Foreign direct investment issues and corporate taxation, including resource taxation issues for developing countries (E/C.18/2013/5 and E/C.18/2013/CRP.13);

(iv) Taxation of development projects;

(v) Capacity-building (E/C.18/2013/CRP.14).

7. Dates and provisional agenda for the tenth session of the Committee.

8. Adoption of the report of the Committee on its ninth session.

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Committee of Experts on International Cooperation in Tax Matters
Ninth session
Geneva, 21-25 October 2013
Item 5 of the provisional agenda*
Adoption of the agenda and organization of work

Proposed organization of work

Date/time	*Item*	*Programme*
Monday, 21 October		
9-10 a.m.		Registration of participants
10-11 a.m.	1	Opening of the session by the representative of the Secretary-General
	2	Election of the Chair and other officers (closed meeting)
	3	Consideration of the rules of procedure and other organizational issues (closed meeting)
	4	Introductory remarks by the Chair of the Committee
	5	Adoption of the agenda (E/C.18/2013/1) and organization of work (E/C.18/2013/2)
	6	Discussion of substantive issues related to international cooperation in tax matters[a]
11 a.m.-1 p.m.	6 (a)	Issues related to the updating of the United Nations Model Tax Convention (E/C.18/2013/3)

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Date/time	*Item*	*Programme*
	6 (a) (x)	Various articles: taxation of services and the provision on taxation of fees for technical services (E/C.18/2013/CRP.5)
		Presenter: Secretariat, Ms. Liselott Kana, Mr. Brian Arnold and others
3-3.30 p.m.	6 (a) (x)	Various articles: taxation of services and the provision on taxation of fees for technical services (*continued*)
		Presenter: Secretariat, Ms. Liselott Kana, Mr. Brian Arnold and others
3.30-6 p.m.	6 (b)	Other issues
	6 (b) (i)	Issues for the next update of the United Nations Practical Manual on Transfer Pricing for Developing Countries (E/C.18/2013/4 and E/C.18/2013/CRP.15)
		Presenter: Secretariat, Mr. Stig Sollund and others
Tuesday, 22 October		
10-11 a.m.		Results from research carried out by the International Bureau for Fiscal Documentation on the practical implementation of the United Nations Model Tax Convention
		Presenter: Representative of the International Bureau of Fiscal Documentation
11 a.m.-1 p.m.	6 (a) (ii)	Article 5. Permanent establishment: (a) Meaning of "connected projects" (E/C.18/2013/CRP.2); (b) Whether a satellite in geostationary orbit could constitute a permanent establishment; (c) Permanent establishment issues in international value added tax cases (E/C.18/2013/CRP.3)
		Presenter: Secretariat and others
3-5.30 p.m.	6 (a) (v)	Article 9. Associated enterprises: update of its commentary (E/C.18/2013/4)
		Presenter: Secretariat and others
5.30-6 p.m.	6 (b)	Other issues
	6 (b) (iv)	Taxation of development projects
		Presenter: Secretariat and others

Date/time	*Item*	*Programme*
Wednesday, 23 October		
10-11.30 a.m.	6 (a) (iv)	Article 8. Shipping, inland waterways transport and air transport: meaning and coverage of the term "auxiliary activities" (E/C.18/2013/CRP.4)
		Presenter: Secretariat and others
11.30 a.m.-1 p.m.	6 (b) (v)	Capacity-building (E/C.18/2013/CRP.14)
		Presentation on the capacity development programme of the Financing for Development Office
		Presenter: Secretariat (Ms. Dominika Halka, Mr. Harry Tonino) and others
		Presentation on tax transaction cost project
		Presenter: CIAT (Inter-American Centre of Tax Administrations) secretariat
3-4 p.m.	6 (a) (vii)	Article 13. Capital gains: the practical implications of paragraph 4
		Presenter: Secretariat, Mr. Tizhong Liao and others
4-5 p.m.	6 (a) (viii)	Article 23. Methods for the elimination of double taxation: conflicts of qualification and conflicts of interpretation in 2012 in the context of the discussion on climate change
		Presenter: Secretariat and others
5-6 p.m.		Additional presentation and discussion on base erosion and profit shifting (BEPS) as cross-cutting issue
		Presenter: Organization for Economic Cooperation and Development Secretariat
Thursday, 24 October		
10-11.30 a.m.	6 (b) (ii)	Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries (E/C.18/2013/CRP.7-12F)
		Presenter: Secretariat (Ms. Dominika Halka, Mr. Harry Tonino) and others
11.30 a.m.-1 p.m.	6 (b) (iii)	Foreign direct investment issues and corporate taxation, including resource taxation issues for developing countries (E/C.18/2013/5 and E/C.18/2013/CRP.13)
		Presenter: Secretariat and others

Date/time	*Item*	*Programme*
3-3.30 p.m.	6 (b) (iii)	Foreign direct investment issues and corporate taxation, including resource taxation issues for developing countries (*continued*)
		Presenter: Secretariat and others
3.30-5 p.m.	6 (a) (ix)	Article 26. Exchange of information
		Presenter: Secretariat, Mr. Armando Lara Yaffar and others
5-6 p.m.	6 (a) (i)	Article 4. Resident: application of treaty rules to hybrid entities (E/C.18/2013/CRP.1 and E/C.18/2013/CRP.7)
		Presenter: Secretariat and others
Friday, 25 October		
10-11 a.m.	6 (a) (vi)	Article 12. Royalties: general consideration, including equipment-related issues
		Presenter: Secretariat and others
11 a.m.-noon	6 (a) (xi)	Various articles: United Nations Model Tax Convention and climate change mechanisms (E/C.18/2013/CRP.6)
		Presenter: Secretariat and others
noon-1 p.m.	6 (a) (iii)	Article 7. Business profits: "force of attraction" and the consideration and explanation of its operation
		Presenter: Secretariat and others
3-4 p.m.	7	Dates and provisional agenda for the tenth session of the Committee
4-5.45 p.m.	8	Adoption of the report of the Committee on its ninth session
5.45-6 p.m.		Closing of the ninth session

Note: The proposed organization of work is tentative. As noted in the report on the eighth annual session of the Committee (E/C.18/2012/6, para. 105), the new membership should decide on the prioritization of the issues under discussion. This will affect timing and means there can be no expectation of particular substantive agenda items being discussed at a specific time.

[a] In this and other agenda items, it is expected that some presentational roles will be played by those current members of the Committee and some others that have been involved in addressing such issues.

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Committee of Experts on International Cooperation in Tax Matters
Ninth session
Geneva, 21-25 October 2013
Item 6 (a) of the provisional agenda*
Discussion of substantive issues related to international cooperation in tax matters: issues related to the updating of the United Nations Model Tax Convention

Model tax convention: issues for consideration by the Committee

Note by the Secretariat**

Summary

The present note provides a brief background of the issues involved and the history of the various items for consideration under agenda item 6 (a) at the ninth session of the Committee of Experts on International Cooperation in Tax Matters. This is particularly for the benefit of new members of the Committee. As indicated in relation to the sub-items of the agenda item, the present note does not address sub-items to be addressed in other notes.

* E/C.18/2013/1.

** The present paper was prepared by the Secretariat. It is an overview of the "state of play" solely to assist Committee consideration and does not necessarily reflect particular views on substantive issues.

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I. Introduction

1. There are a range of specific issues on the provisional agenda for the annual session that involve consideration of the United Nations Model Double Taxation Convention between Developed and Developing Countries (the United Nations Model) (available from un.org/esa/ffd/tax/unmodel.htm). Work in this area would be expected to feed into the next version of the United Nations Model, which should be completed within the four-year terms of current members.

2. The mandate of the Committee contained in Economic and Social Council resolution 2004/69 specifically refers to its role to "keep under review and update as necessary the [United Nations Model]" while noting that the Committee should "give special attention to developing countries and countries with economies in transition" in dealing with that and other aspects of its mandate. The agenda sub-items dealing with the Model for the ninth session of the Committee under item 6 (a) are listed below, with some explanation of the issues and prior discussions.

II. Agenda sub-items

A. Sub-item (i) Article 4. Resident: application of treaty rules to hybrid entities

3. At its seventh session in 2011, the Committee decided, inter alia, as noted in the report of that session (E/2011/45) that:

> 118. With the latest update of the United Nations Model Convention completed, the Committee considered that it would be useful to examine a series of issues by having papers presented for discussion at the eighth session, in 2012. The question of whether to create subcommittees or working groups would be considered as part of that discussion. In that regard, the Committee decided that:
>
> - Victor Thuronyi would provide a paper on hybrid entities, focusing on the classification of non-resident entities.

4. Mr. Thuronyi provided a paper for the Committee entitled "Note on coordination rules as a solution to tax arbitrage" (E/C.18/2012/CRP.7) for the eighth session of the Committee in 2012. The report for that session (E/2012/45) records the discussions of the note and outcomes as follows:

> 87. The main finding of the paper was that international arbitrage, based on situations where a transaction, for tax purposes, is treated differently by the countries having an interest in the transaction will become more frequent as the taxpayer(s) seek to take advantage of that inconsistent tax treatment across different tax jurisdictions. In his paper Mr. Thuronyi proposed that even in the case of different tax policies, countries may reduce such arbitrage by instituting harmonization or coordination rules. Such rules would, in particular, seek to eliminate dual residency issues.
>
> 88. The participants recognized the issue of arbitrage in relation to hybrid entities as an important one that needs to be studied further. There was caution within the Committee, however, about addressing the issue too broadly. After

some discussion, it was agreed that the immediate way forward was to first tackle the problem within the application of a treaty and country experience, including the experiences of developing countries. Henry Louie, a Vice-Chair of the Committee, offered to produce a paper presenting how treaty provisions are applied in this context, within the United States of America, including examples where benefits are given or denied, and why. Mr. Louie's offer was accepted. It was decided that Mr. Thuronyi's paper would also be made available at the ninth session as a useful elaboration of some of the issues. He was thanked for his contribution.

B. Sub-item (ii) Article 5. Permanent establishment

(a) Meaning of "connected projects"

5. As part of its desire to consider a series of issues in 2012, the Committee, at its seventh session in 2011, requested a paper from then-Committee member Claudine Devillet on the meaning of "connected" in relation to article 5. It noted in its report of the seventh session that:

> 31. It was necessary to clarify in paragraph 12, the meaning of the word "connected" to describe projects that were sufficiently related to be added together, and it was decided to include that question in the catalogue of issues.

6. The paper that resulted from the Committee's request was entitled "Note on United Nations Model Tax Convention article 5: the meaning of 'connected projects'" (E/C.18/2012/CRP.5). The paper was considered by the Committee, and the report of the eighth session notes:

> 64. The discussion on the topic of connected projects was facilitated by a note prepared by Claudine Devillet (E/C.18/2012/CRP.5), which addressed the provision in article 5 (3) (b), which states that:
>
> "3. The term 'permanent establishment' also encompasses:
>
> ...
>
> "(b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days within any 12-month period commencing or ending in the fiscal year concerned."
>
> 65. In presenting her note, Ms. Devillet recalled the mandate given by the Committee at its previous session that a note be prepared to clarify the meaning of "connected projects" within the context of article 5 (3) (b). She mentioned that the main finding of the Subcommittee on the Taxation of Services was that the term was used as a criterion to determine whether or not there was a permanent establishment when services are performed in the source country by employees or other personnel of a non-resident entity for a period determined by the threshold, which in this case was a threshold presence of more than 183 days. In this regard, the question whether different projects could be grouped together is vital for the purposes of the "presence test".

66. Ms. Devillet indicated, however, that another member of the Committee and the Subcommittee, Anita Kapur, had a different understanding about the physical presence of personnel rendering services in a source country, and she invited Ms. Kapur to outline her position. Ms. Kapur indicated that she agreed that the service has to be furnished to an entity in the source State, but she disagreed with the fact that the performance of the service had to take place in the source State. Ms. Kapur considered that the physical presence of personnel or employees is not required by the wording of the article, which talks about where the service is furnished and not where it is performed. The requirement that "activities of that nature continue within a Contracting State" did not, in her view, imply "performance" in that State — it would meet this test if the service was furnished to the Contracting State. There was some discussion about these two interpretations, but no conclusion was reached.

67. Ms. Devillet also indicated that article 7 (1) (c) of the United Nations Model Convention, which deals with "force of attraction", might eventually be the appropriate place to resume with Ms. Kapur's concerns. Ms. Devillet further pointed out that the purpose of the paper is to explain the meaning of connected projects in the context of article 5 (3) (b).

68. The nature and forms of providing services has changed over the years. In this context, it is not uncommon for services to be furnished in a country by an entity from outside that country after a physical presence of a short duration of time, sometimes only to ensure the installation of equipment. In such cases, some speakers argued that the wording of the Model text may establish the existence of a permanent establishment if other necessary conditions are met, but other participants expressed the view that such an interpretation could not be supported by the language of article 5 (3) (b) and sound treaty interpretation. Some speakers also explained that they, as treaty negotiators, had agreed to the language of article 5 (3) (b) with the understanding that it required that the services require a physical presence in the source State for a service permanent establishment to exist.

69. In the discussion, a majority of those speaking considered that a physical presence was required by article 5 (3) (b). There were, however, speakers who considered that the text of article 5 (3) (b) was not so clear and who suggested that countries that want to make sure that a physical presence is required should use a text that clearly makes such a requirement, for example the alternative text in the OECD Model. There were other speakers who did not consider a physical presence as necessary to apply the provision.

70. A member of the Committee suggested that the session should not just try to avoid difficulties or dismiss concerns raised by a number of countries as these diverging views on interpretation may potentially end up in conflicts, or in court, with costly financial implications for taxpayers and national administrations. The work of the Committee ought to be focused on assisting countries by pointing out these diverging views so that when countries enter bilateral tax treaty negotiations these matters can be discussed and resolved. A paper discussing these options was recommended.

71. Following that recommendation, Ms. Devillet explained why the use of the provision "same or connected projects" should be regarded from the point of view of the enterprise furnishing the service and not from the perspective of

the consumer, a view which is consistent with the OECD commentary. In fact, she argued, if an enterprise provides services to a consumer for two different projects through two different departments using different personnel, then the two projects are not related and therefore the provision on "same or connected projects" cannot be applicable. She indicated, however, that two members of the Subcommittee disagreed with that understanding.

72. The comment provided by Liselott Kana concerned the fact that in the OECD commentary, the point of view of the enterprise furnishing a service is considered only in the case of the "same" project, therefore the point of view could not automatically be assumed to be valid for the case of "connected projects". The second comment from Ms. Kapur is that both the points of view of the enterprise furnishing the service and of the consumer should be considered in order to determine if "the same or [a] connected" project exists.

73. While some Committee members and other participants held the same view as Ms. Devillet, others thought the purpose of the provision on "same or connected projects" was to avoid a situation where an enterprise that does not want to have a permanent establishment in a country where it provides service would just split projects up into different parts and seek to avoid the threshold of the 183 days in any 12-month period. With this in mind, it seems logical to look at the provision from the consumer's point of view, rather than that of an enterprise that is trying to avoid the provision. Other members argued that the difficulties and restrictions implied by using the wording "the same or a connected project" could be avoided by simply not including such wording in the treaty text and that their view should also be reflected in the paper.

74. Ms. Kapur clarified her position by explaining that when it is obvious that two projects are not connected to each other both from the perspectives of the enterprise and of the consumer there is no problem. However, she continued, in the hypothetical case of a company from a source country buying machinery from a non-resident company and also retaining services from the same company to provide software to run the machinery, this is clearly the same project, or at least the two projects are connected from the perspective of the consumer. However, the machinery and the software may be provided by two different departments of the provider. In this case, she concluded, the provision should apply to determine that there is a permanent establishment once other criteria are met.

75. In the end it was recommended that Ms. Devillet redraft the paper, including the type of situation described by Ms. Kapur and taking into account other comments made. In drafting the paper within the Subcommittee, Ms. Kana agreed to give her contribution so that her comments on separating the cases of "the same project" and "connected projects" would also be dealt with.

(b) Whether a satellite in a geostationary orbit could constitute a permanent establishment

7. The background to the issue is that for the version released in 2010 of the Model Tax Convention on Income and on Capital of the Organization for Economic Cooperation and Development (the OECD Model) (available from oecd.org/tax/

treaties), paragraph 5.5 was added to the commentary on article 5 of the OECD Model. It reads:

> 5.5 Clearly, a permanent establishment may only be considered to be situated in a Contracting State if the relevant place of business is situated in the territory of that State. The question of whether a satellite in geostationary orbit could constitute a permanent establishment for the satellite operator relates in part to how far the territory of a State extends into space. No member country would agree that the location of these satellites can be part of the territory of a Contracting State under the applicable rules of international law and could therefore be considered to be a permanent establishment situated therein. Also, the particular area over which a satellite's signals may be received (the satellite's "footprint") cannot be considered to be at the disposal of the operator of the satellite so as to make that area a place of business of the satellite's operator.

8. When the Committee was considering possible revisions to the commentary to article 5 in the United Nations Model, at its seventh session, it did not include a paragraph dealing with geostationary orbits. As noted in the report of the seventh session:

> 30. It was decided to delete the proposed quoted OECD paragraph 5.5, dealing with whether a satellite in geostationary orbit could constitute a permanent establishment, and to instead include the discussion of the matter in the catalogue of issues.

(c) Permanent establishment issues in international value added tax cases

9. At its seventh session, in 2011, the Committee noted (as indicated in the report of that session) that:

> 118. With the latest update of the United Nations Model Convention completed, the Committee considered that it would be useful to examine a series of issues by having papers presented for discussion at the eighth session, in 2012. The question of whether to create subcommittees or working groups would be considered as part of that discussion. In that regard, the Committee decided that:
>
> ...
>
> • Jürg Giraudi would present a scoping paper on value-added tax, addressing cross-border issues related to permanent establishments

10. Mr. Giraudi made a presentation to the Committee at its eighth session, in 2012, and the report of that session noted:

> 89. As decided by the Committee at its seventh session, Jürg Giraudi presented a paper on the topic of permanent establishment issues in international value added tax cases (E/2011/45, para. 118). Mr. Giraudi reminded the Committee of its broader mandate, which goes beyond tax treaties. More than 150 countries have a value added tax (VAT) or goods and service tax (GST) in place. VAT/GST is an important revenue creator for tax administrations, with less distortionary effects on economic growth than income taxes. To date, there is little coordination in terms of indirect taxation: aside from the Ottawa Taxation Framework Conditions (1998), which focus on

taxation issues arising from e-commerce, Mr. Giraudi mentioned the OECD International VAT/GST Guidelines (2011) and the first meeting of the OECD Global Forum on VAT, held in November 2012. He expressed the view that international consensus on some VAT issues is lacking and that there is scope for additional work while expressing caution that work carried out by other organizations, such as OECD, must not be duplicated. The focus of the work of OECD has been on VAT on services and intangibles however, rather than VAT on the supply of goods.

90. Mr. Giraudi introduced VAT as an indirect tax on consumption. The financial burden is borne by the final consumer according to the destination principle. Imports of goods are subject to an import VAT, VAT on local supplies underlies local VAT regimes and exports are zero rated.

91. Subsequently, Mr. Giraudi introduced some examples displaying problems that could arise from VAT when companies engage in cross-border trade. He posed some questions concerning VAT, such as whether a VAT registration of a non-resident seller could trigger a permanent establishment, and thus income taxes. Moreover, he questioned what kind of consequences arise, in terms of VAT, from transfer pricing adjustments. Finally, Mr. Giraudi proposed that a group should be established to study cross-border VAT implications, including different practices, and that the group should ultimately make recommendations for the adoption of best practices.

92. The members of the Committee showed support for further work on the issues raised by Mr. Giraudi. It was agreed, however, that future work in this area should not only focus on goods but also on services. There was agreement that Mr. Giraudi and Marcos Pereira Valadão, as members of the Committee, should work together to produce a note on cross-border VAT issues to be presented at the ninth session of the Committee, drawing upon other expertise, as needed. Mr. Giraudi was thanked for his work and the secretariat remarked that the Committee was now considering VAT and GST for the first time since its establishment — a potentially important development in the history of the Committee.

11. A separate note on the issues is expected for the ninth session.

C. Sub-item (iii) Article 7. Business profits: "force of attraction" and the consideration and explanation of its operation

12. The issue was addressed in the conference paper entitled "Note on tax treaty issues arising from the granting and trading of emissions permits and emissions credits under the UN Model Tax Convention" (E/C.18/2012/CRP.6) which notes:

> 88. A bilateral treaty that follows the UN Model will contain a "limited force of attraction" rule. Under such a rule, the other Contracting State (the PE State) may also tax profits attributable to (i) sales of goods or merchandise in that State of the same or similar kind as those sold through the PE and (ii) other business activities carried on in that State of the same or similar kind as those effected through the PE. The question may therefore arise whether the profits derived from the sale of emissions permits/credits in the other

Contracting State that are not attributable to a PE may be taxed in that State on the basis of the "limited force of attraction" rule.

89. The "limited force of attraction" covers the "same or similar" activities as those carried on through the PE. The activities carried on through a CDM/JI project PE are activities resulting in a reduction of greenhouse gas emissions which gives rise to the grant of credits if the necessary conditions are fulfilled. These activities generally do not include the trading, as such, of emissions credits for the enterprise. This means that the "limited force of attraction" rule would not apply if an enterprise operating a CDM/JI project PE in a Contracting State directly sold, in that State, emissions credits purchased on the secondary market or issued with respect to a CDM/JI project carried on in another State. Such a sale would indeed not be identical or similar to a possible sale through the CDM/JI project PE of credits granted in respect of the activities carried on through the CDM/JI project.

90. The activities carried on through a PE which is required to hold emissions permits (i.e. to participate in an emissions trading programme) are generally industrial activities giving rise to polluting emissions. These activities generally do not include the trading of emissions permits for the enterprise as a whole (as opposed to the trading of emissions permits in connection with the PE's own compliance obligations). The direct sale by the enterprise, in the PE State, of emissions permits granted to or acquired by the enterprise in connection with polluting activities carried on through other parts of the enterprise would therefore not be similar to the sale through the PE of "excess" emissions permits relating to the emissions produced through the PE.

91. The "limited force of attraction" rule would only apply if the functions of the PE encompassed the management and trading of emissions permits/credits for different parts of the enterprise. In such a case, the profits attributable to the management and trading functions exercised by the PE could be taxed in the PE State, as well as profits relating to trading functions performed directly by the enterprise in the PE State without the involvement of the PE.

> The "limited force of attraction" rule is only found in a limited number of treaties. Its operation depends upon the existence of a similar rule in domestic law so that, even if it would be included in a treaty, it may not be operative in practice. The Commentary on article 7 of the UN Model does not address the operation of the rule in any great detail. There is, consequently, no certainty as to exactly which transactions the rule could apply. The application of the "limited force of attraction" rule to income derived in connection with emissions permits/credits could therefore be clarified in the UN Commentary.

13. "Force of attraction" was considered in the discussion of that paper at the eighth session of the Committee. It was included in the catalogue of issues on a more general basis as follows (as noted in the report of that annual session):

44. A bilateral treaty that follows the United Nations Model Convention may contain a "limited force of attraction" rule. The question may therefore arise whether the profits derived from the alienation of emission permits and credits in the other Contracting State that are not attributable to a permanent establishment may be taxed in that State on the basis of that rule. There was general agreement to add the issue of "force of attraction" to the catalogue of issues.

A. Sub-item (iv) Article 8. Shipping, inland waterways transport and air transport: meaning and coverage of the term "auxiliary activities"

14. At its seventh session in 2011, the Committee noted (as indicated in the report of that session) that:

> 37. Several members expressed concern over the comprehensive changes proposed in the commentary on article 8. It was argued that the changes would widen the scope of the article and therefore needed to be discussed in detail in order to assess their implications.
>
> 38. Consequently, the OECD commentary paragraphs added in 2005, which referred to the income from directly connected and ancillary activities of shipping and air transport enterprises, were removed. It was decided to include in the catalogue of issues for future discussion the term "auxiliary" in the context of the auxiliary activities that would come within the operation of the article.
>
> 39. It was agreed to delete the proposed paragraph 8 on the issue of including fishing, dredging or hauling activities on the high seas under the commentary on this article. Concerning paragraphs 12 and 13 it was agreed to retain the text in strikethrough in the update, which meant that the correct reference for quoted paragraphs 4 to 14 would be to the 2003 OECD commentary.

15. Mr. van der Merwe and the Secretariat prepared a note for the Committee's eighth session entitled "Auxiliary activities under article 8" (E/C.18/2012/5). The note was discussed at that session and the report of the session noted:

> 93. As requested by the Committee, Ron van der Merwe, with Michael Lennard of the secretariat, introduced a note on auxiliary activities under article 8 (E/C.18/2012/5). It was noted that at the seventh session of the Committee concern had been expressed about updating the commentary on article 8 (Shipping, inland waterways transport and air transport) on the "auxiliary activities" sufficiently closely connected to the direct operation of ships and aircraft to come within the ambit of the article. Some members felt that updating the commentary in a way that was similar to the updates made to the OECD Model could, in effect, broaden the scope of the article and give a greater exception to the normal treatment under articles 5 and 7 than was justified.
>
> 94. In his presentation, Mr. Lennard compared the current wording used in both the United Nations Model and the OECD Model commentaries, highlighting that OECD refers to "ancillary" activities rather than "auxiliary"

activities, perhaps in order to distinguish these activities from the "preparatory or auxiliary" activities under article 5 (4) of its Model. He indicated that some usages in the commentary, such as references to advertising as "propaganda" and single-use hotels, as well as to containerization as a recent phenomenon, clearly needed updating.

95. During the discussion, some Committee members expressed the view that the terms "auxiliary" and "ancillary" are not interchangeable and that referring to the latter would broaden the scope of application of the aforesaid provision, and thus reduce source State taxing rights. In addition, it was stated that "auxiliary", being a more precise word, was easier to interpret than "ancillary". Others expressed support for updating the terminology in the Model commentary along the lines of the current language adopted in the OECD Model commentary, thus referring to "ancillary" activities instead of "auxiliary" activities. As a result, the Committee agreed to ask the secretariat to revise the abovementioned note in order to reflect those views, and to that end it invited comments by the end of 2012. Moreover, as the current membership of the Committee is due to expire on 30 June 2013, it was agreed to include the aforesaid issue of revising the commentary in relation to "auxiliary activities" in the catalogue of issues to be further considered by the members of the Committee at the next annual session. Mr. van der Merwe and the secretariat were thanked by the Committee for their work on the matter.

E. Sub-item (v) Article 9. Associated enterprises: update of its commentary

16. Consideration of revisions to the commentary on article 9 were deferred by the Committee until the revision of the United Nations Practical Transfer Pricing Manual for Developing Countries, and then placed on the agenda of the following session. The background to this agenda item is discussed in more detail in a separate note from the Secretariat (E/C.18/2013/4).

F. Sub-item (vi) Article 12. Royalties: general consideration, including equipment-related issues

17. The topic was included in the catalogue of issues at the time when the update in 2011 of the United Nations Model was completed. The report of the seventh annual session noted:

47. It was noted that the consideration of article 12 was difficult for the purposes of the update, owing to the fundamental differences in approaches between the United Nations Model Convention and the OECD Model Convention with regard to the taxation of royalties. Nevertheless, article 12 had not been fully considered by the Committee, and it was agreed that it would be included in the catalogue of issues for future discussion. Concern was expressed about the last part of paragraph 11, which limited the relevant scope of information to that arising from previous experience. A new sentence was drafted to reflect the minority view and adopted for inclusion immediately following quoted paragraph 11 of the commentary. A view was also expressed that payments referred to in quoted paragraphs 14, 14.1, 14.2, 14.4, 15, 16,

17.2 and 17.3 might constitute royalties. A new sentence was drafted to acknowledge that view and was adopted for inclusion.

G. Sub-item (vi) Article 13. Capital gains: the practical implications of paragraph 4

18. As noted in the commentary to article 13 of the United Nations Model:

> 8. This paragraph, which broadly corresponds to paragraph 4 of the OECD Model Convention, allows a Contracting State to tax a gain on an alienation of shares of a company or on an alienation of interests in other entities the property of which consists principally of immovable property situated in that State. It is designed to prevent the avoidance of taxes on the gains from the sale of immovable property. Since it is often relatively easy to avoid taxes on such gains through the incorporation of a company to hold such property, it is necessary to tax the sale of shares in such a company.

19. The Committee has recognized that there will be issues in applying article 13 (4) in practice and noted in its report of the seventh session that:

> 48. The practical implications of paragraph 4 of article 13 would be included in the catalogue of issues for future discussion.
>
> 49. Many administrative issues involved in the implementation of the article would be addressed in the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries.

20. A paper on some of the compliance issues relating to that paragraph, entitled "Compliance issues in regard to paragraph 4 of article 13 of the United Nations Model Double Taxation Convention" (E/C.18/2012/CRP.10), was presented to the eighth session in 2012.

H. Sub-item (viii) Article 23. Methods for the elimination of double taxation: conflicts of qualification and conflicts of interpretation in 2012 in the context of the discussions on climate change

21. This issue arose as part of the consideration of issues related to climate change, but has a potentially wider significance, especially as the Committee has not considered in depth the issues raised by the OECD publication *The Application of the OECD Model Tax Convention to Partnerships* (Paris, 1999) and the changes made to the commentary to article 23 of the OECD Model as a result of that.

22. The paper entitled "Note on tax treaty issues arising from the granting and trading of emissions permits and emissions credits under the United Nations Model Tax Convention" (E/C.18/2012/CRP.6), presented to the eighth session, in 2012, addresses the issue as follows:

> 124. A "conflict of qualification" arises where, due to differences in the domestic law characterisation of an item of income in the State of source and the State of residence, the State of source applies (with respect to that item of income) a different treaty provision than the State of residence would have applied. Such conflicts may occur in the following cases:

- one State considers that gains from trading emissions permits/credits are covered by paragraph 1 of Article 13 (because the emissions permits/credits constitute "immovable property" according to the domestic law of that State) and the other State disagrees; or
- one State considers, in accordance with its domestic law, that profits or gains realized by an NGO or a Government upon the first sale of emissions credits are business income dealt with under Article 7 or gains dealt with under paragraph 2 of Article 13 whilst, under the domestic law of the other State, the income realised upon such alienation is not business income but a gain to which paragraph 6 of Article 13 is applicable; or
- one State, in accordance with its domestic law, treats the income realised by an NGO or a Government upon the issuance of emissions credits as other income to which paragraph 3 of Article 21 is applicable whilst the other State, in accordance with its domestic law, does not recognise income upon the issuance of emission credits but treats the income realised upon their alienation as a gain to which paragraph 6 of Article 13 is applicable.

125. Paragraphs 32.1 through 32.7 of the Commentary on Articles 23A and 23B of the OECD Model contain guidance on how relief from double taxation is to be provided under the OECD Model in cases of conflicts of qualification. Where the OECD Model permits the source State to tax an item of income, as that item of income is characterised under the domestic law of the source State, the residence State is obliged under Article 23A or 23B to relieve any double taxation of such income, even if the residence State characterises the income differently under its domestic law and would thus apply a different article of the Model. In these situations, the OECD Commentary considers that the State of source has taxed the item of income "in accordance with the provisions of this Convention".

126. The Commentary on Article 23 of the UN Model contains no such guidance. During the seventh meeting of the Committee of Experts on international cooperation in tax matters, there was no consensus with respect to the opportunity for the UN Model to endorse the OECD Commentary on conflicts of qualification. Due to lack of time, it was decided not to cover this issue in the 2011 version of the UN Model but to include it in the catalogue of items for future discussion and work. If the State of residence were to disagree with the guidance found in the OECD Commentary on how relief from double taxation is to be provided in a case where there is a conflict of qualification, the case would need to be resolved under Article 25 (Mutual Agreement Procedure) or the affected taxpayer would have to pursue judicial or administrative remedies in the State of residence.

The elimination of possible double taxation resulting from differences of characterization in the domestic law of the State of source and the State of residence should as far as possible be sought. If any double taxation would arise, the trading of emissions permits would be hindered and would not be as efficient as expected under the Kyoto Protocol. Therefore, the application of paragraphs 32.1 through 32.7 of the OECD Commentary under Articles 23A and 23B of the UN Model should be discussed as soon as possible in order to reach a consensus in this respect.

I. Sub-item (ix) Article 26. Exchange of information

23. The article on the exchange of information was changed as part of the update of the United Nations Model in 2011. The discussion of the issue at the 2012 session outlines some of the purposes of this inclusion on the catalogue of issues and agenda, especially in the light of the importance of this issue to both developing and developed countries and current international developments. The report of the eighth session notes:

> 62. Robin Oliver, a member of the Committee, provided an update on the exchange of information. After recalling that the Committee had focused its work in this area on updating article 26 of the United Nations Model Convention, he reported on some relevant developments within the OECD. The following three main issues on the exchange of information were highlighted and discussed by the Committee:
>
> (a) The meaning of "foreseeably relevant", in paragraph 1 of the article;
>
> (b) Requests for information regarding groups of taxpayers;
>
> (c) Automatic information exchange, as opposed to information exchange on request.
>
> 63. Recognizing that these issues required further analysis, and given that the current members of the Committee will finish their terms on 30 June 2013, the Committee agreed to include the issues in a catalogue of issues recommended for further consideration by the new membership. One Committee member referred, in the context of issue (b) above, to the importance of implementing taxpayer registration in order to take full advantage of the automatic exchange of information. Another Committee member suggested considering the issue of the use of information for purposes other than taxation, and this was added to the list of issues for consideration by the new membership.

J. Sub-item (x) Various articles: taxation of services and the provision on taxation of fees for technical services

24. This agenda item will be dealt with separately by a paper for the ninth session (E/C.18/2013/CRP.5).

K. Sub-item (xi) Various articles: United Nations Model Tax Convention and climate change mechanisms

25. This work was begun in 2010 by the Committee after some work by the OECD and papers from the Secretariat on tax cooperation on climate change (E/C.18/2010/CRP.12 and E/C.18/2011/CRP.9). At the seventh session in 2011, a subcommittee was set up to consider the issue in more detail.

26. At its eighth session, the Committee considered a paper on tax treaty issues arising from the granting and trading of emissions permits and emissions credits under the United Nations Model Tax Convention. The report of the session noted the discussion in some detail. The result will be a slightly modified new draft version of the paper for consideration at the ninth session, and the areas where changes will be made as well as relevant passages indicating the work's status are in bold.

> 25. The Coordinator of the Working Group on Tax Treaty Issues related to Climate Change Mechanisms, Claudine Devillet, introduced the note on tax treaty issues arising from the granting and trading of emission permits and emission credits under the United Nations Model Convention (E/C.18/2012/CRP.6). Ms. Devillet noted that she was presenting a first draft prepared by a small working group, which placed special emphasis on issues about which clarifications and feedback were needed. The draft reflected some divergent views as between different members of the Working Group. The Coordinator expressed her hope that the discussion of the subject would be useful and that comments received could be incorporated into the draft, which would be made publicly available through the Committee's website. The Working Group would also seek written feedback from the members of the Committee. **An updated draft would be presented at the ninth annual session of the Committee in 2013.**
>
> 26. The substantive issues discussed were based on the market-based mechanisms established under the Kyoto Protocol, such as emissions trading, the Clean Development Mechanism, the Joint Implementation Mechanism and activities related to land use, land use change and forestry. Other cap-and-trade systems would, however, be similar enough to allow for the tax-treaty analysis of the market-based mechanisms to serve as a basis for the analysis of those systems as well.
>
> 27. The discussion focused on potential tax treaty issues that could arise in connection with the granting of emission permits by national or regional authorities, the trading of such services across borderland the issuance and trading of certified emission reductions, emission reduction units and removable units. It was noted that such permits might be auctioned, otherwise sold or granted for free, and that there are different ways in which countries might consider activities relating to emissions permits as sources of income.
>
> **Granting of emission permits and credits**
>
> 28. Ms. Devillet noted that when an emission permit is granted for free, a minority of countries considers this to be taxable income at the moment of granting. A majority of countries considers emission permits as income at the specific time when they are sold or used, and they tax them at that point in time.

29. She observed that, in general, article 7 of the United Nations Model Convention (business profits) would apply when an emission permit was granted for business activities. Profits arising at the time of the granting would be taxable on a residence basis unless they were attributable to a permanent establishment situated in the other Contracting State. Consequently, where an enterprise exercises activities generating polluting emissions in the other Contracting State, those activities would generally be exercised through an installation constituting a permanent establishment and the profits from the granting of an emission permit would be attributable to that establishment and would be taxable in the State where it was situated.

30. Ms. Devillet clarified that the granting of emission permits to business for free by Governments was included in the analysis due to the fact that during the initial trial period of the cap-and-trade system of the European Union (the European Union Emissions Trading Scheme) emission permits had been granted for free. This was done to establish an adequate number of emission permits and to grant European businesses time to adapt to a market-based emissions trading system.

31. Ms. Devillet noted that since the beginning of 2012, emissions from all domestic and international flights arriving or departing to or from airports within the European Union have been covered by the trading scheme.[4] According to article 8 of the United Nations Model Convention, a foreign enterprise engaged in such transportation activities would therefore be taxable on any profits that could be recognized as a result of the granting of emission permits by a government free of charge only in the State of its place of effective management, regardless of whether or not such profits might be attributable to a permanent establishment in another State.

32. Theoretically, emission permits could be granted to owners of immovable property, but not because of business activities undertaken. **Income arising at the time a permit is granted for free would consequently fall under article 6 of the United Nations Model Convention as income from immovable property. It was agreed that an example should be provided to clarify the issue.**

33. Article 6 would also apply to income arising from the granting of a permit in relation to agriculture or forestry activities expressly covered under paragraph 1 of article 6. **There was some disagreement with the suggestion in the note that income from mining activities would be treated differently from income from agriculture or forestry activities in article 6. Ms. Devillet agreed to investigate the issue and to suggest appropriate wording for the matter.**

34. Ms. Devillet noted the view expressed in the note that articles 12 and 14 of the United Nations Model Convention referring to royalties and independent personal services do not apply to the granting of emission permits.

35. Income arising at the time a permit is granted for free would generally be covered either by articles 6, 7 or 8 of the United Nations Model Convention. Article 21 would, however, apply in cases where the emissions of greenhouse gases with respect to which permits are granted did not result from the

[4] The application of the scheme to flights into and out of the European Union has since been delayed: see http://ec.europa.eu/clima/news/articles/news_2012111202_en.htm.

carrying on of a business. Ms. Devillet agreed to research whether this issue is pertinent to the Model, especially in so-called "triangular" cases.

36. The granting of emission credits was not discussed separately from emission permits due to analogies in terms of potential tax treaty issues.

Trading of emission permits and credits

37. There are no internationally recognized definitions of emission permits and credits. Generally, domestic accounting and tax laws have to be consulted to ascertain if emission permits and credits are to be treated as commodities or intangible assets. Agreement was reached that in future the deliberations of the working group should include work on definitions and characterizations of emission permits and credits. In addition, there was agreement that the word "alienation" instead of "sale" should be used in the context of trading in order to capture the fact that there might be circumstances under which emission permits and credits have to be handed over to authorities.

38. The trading of emission permits and credits and the taxation of income, which depend on treatment under domestic law, are covered by articles 6, 7 and 8 of the United Nations Model Convention. Under some circumstances, income from the alienation of emission permits and credits may also be categorized as capital gains from intangible property, in which case article 13 would apply.

39. Income derived by an enterprise of a Contracting State from the alienation of an emission permit or credit directly granted to the enterprise in connection with polluting activities carried out by it through a permanent establishment situated in the other Contracting State would generally be attributable, in whole or in part, to that establishment.

40. Income derived by an enterprise from the alienation of an emissions permit directly granted to that enterprise in connection with polluting activities carried out by it through a permanent establishment would generally be attributable to that establishment even if it had not been involved in the alienation. With respect to permits acquired on secondary markets, there are no specified rules. The taxation thereof would thus depend on circumstances.

41. In cases in which an enterprise of a Contracting State has been granted emission permits in connection with the emissions of a permanent establishment in another Contracting State and transfers those permits to another part of the enterprise, the fair market value of the permit at the time of the transfer might be taken into consideration in order to determine the profits attributable to that permanent establishment.

42. The income derived by a foreign enterprise from the alienation of emissions credits granted to it with respect to a project that it owns (in whole or in part) may be taxed in the host country where the project constitutes a permanent establishment. Such income may also be taxed in the host country where the foreign enterprise has performed services under a project development agreement through a fixed place of business and the profits from the alienation are attributable to that permanent establishment.

43. **Profits related to the alienation of emission credits acquired on the secondary market by an enterprise are not attributable to a permanent establishment constituting part of a Clean Development Mechanism project. In such a case, no direct link exists between the credits and the Clean Development Mechanism project that has generated them. A majority of the members of the Working Group considered emissions credits to be fungible instruments.**

44. **A bilateral treaty that follows the United Nations Model Convention may contain a "limited force of attraction" rule. The question may therefore arise whether the profits derived from the alienation of emission permits and credits in the other Contracting State that are not attributable to a permanent establishment may be taxed in that State on the basis of that rule. There was general agreement to add the issue of "force of attraction" to the catalogue of issues.**

45. Article 6 of the United Nations Model Convention applies to income generated from immovable property, with particular reference to income from agriculture or forestry activities, and thus applies when enterprises trade emission permits and credits relating to their income generated by immovable property and agricultural or forestry activities. The note concluded that it would not apply to profits from subsequent resale of these permits and credits by persons for whom those profits would not constitute income from their agricultural or forestry activities. **Ms. Devillet agreed to introduce a clarification or to reflect the fact that various members of the Committee considered that income from mining activities is also covered by article 6.**

46. Given that the emissions from shipping activities are not covered under cap-and-trade mechanisms, article 8 of the United Nations Model Convention does not currently apply to the trading of emission permits and credits. **There was agreement that the Working Group would consider the application of article 8 in terms of water transportation after the update of the commentary on that article was decided upon.**

47. **In respect of the definition of immovable property, it was agreed that a note of advice would be added indicating that during treaty negotiations contracting parties should clarify in which cases they would consider emissions permits/credits as immovable property covered by article 6 or by paragraph 1 of article 13.**

48. In the case that non-profit establishments would alienate emission permits or credits, paragraph 6 of article 13 would apply, unless paragraph 1 of that article would be applicable.

49. **The question of whether leasing of emission permits or credits would fall under article 12 was also discussed. The leasing of permits or credits would not, however, make sense under the cap-and-trade system of the Kyoto Protocol. Ms. Devillet agreed to clarify the issues in the revised note. With regard to transfer pricing, the Working Group asked for guidance from transfer pricing experts in order to complete the note on this issue.**

50. Ms. Devillet and others who worked on the paper were thanked for their detailed consideration of the issues.

III. Common issues for consideration

27. The matters for consideration by the Committee in relation to the updating of the United Nations Model included under the various agenda sub-items include:

(a) The priority that should be accorded to particular elements of the present work;

(b) The relationship to work being conducted by other organizations and entities;

(c) Which issues should have subcommittees formed to consider them and which issues should be deferred or else dealt with by a general update subcommittee;

(d) The extent to which any such subcommittee should be asked in its mandate to consider certain issues, while leaving available the option for the subcommittee to recommend other such issues for consideration;

(e) The Coordinator for any such subcommittees (traditionally chosen from among members of the subcommittees, when possible);

(f) The extent to which the membership of any such subcommittee should be determined at the annual session, or could be agreed upon later or could be left to the discretion of Coordinators, bearing in mind the need for broad and balanced representation in practical terms;

(g) The need for different subcommittees to consult on issues that have obvious "cross-cutting" aspects.

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Committee of Experts on International Cooperation in Tax Matters
Ninth session
Geneva, 21-25 October 2013
Items 6 (a) (v) and (b) (i) of the provisional agenda*
Discussion of substantive issues related to international cooperation in tax matters: issues related to the updating of the United Nations Model Tax Convention: article 9: associated enterprises: update of its commentary; other issues: issues for the next update of the United Nations Practical Manual on Transfer Pricing for Developing Countries

Transfer pricing issues for consideration by the Committee

Note by the Secretariat**

Introduction

1. There are two specific transfer pricing issues on the provisional agenda for the ninth annual session. First, item 6 (a) (v) is the consideration of the commentary to article 9 on associated enterprises. In essence, the present consideration is the carry-over of a brief consideration of that commentary at the seventh annual session in 2011 as part of the finalization of the United Nations Model Double Taxation Convention between Developed and Developing Countries (the United Nations Model Tax Convention).

2. This first issue involves consideration of the commentary, rather than article 9 itself, and it was agreed by the Committee in 2011 that such a discussion should await completion of the (now finalized) United Nations Practical Manual on Transfer Pricing for Developing Countries (the Manual).

3. The second issue (item 6 (b) (i)) is that of which issues should be addressed in the next update of the Manual. As noted below, some suggestions for further issues

* E/C.18/2013/1.

** The present paper was prepared by the Secretariat. It is an overview of the "state of play" solely to assist Committee consideration and does not necessarily reflect particular views on substantive issues.

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to be addressed by the Manual are contained in the Manual itself; others flow from the work in developing the Manual and from comments on it.

4. Both of the issues and options available to address them are dealt with in more detail below.

Revision of the commentary to article 9

Background to the issue

5. Revision of the commentary to article 9 is on the agenda for the ninth annual session of the Committee as a result of a decision taken at the eighth annual session in 2012. That decision was grounded in an accommodation reached by the Committee at its seventh annual session in 2011, when the issue of the commentary to article 9 was last discussed. That was in the context of the agenda item on the United Nations Model Tax Convention update, and the update was approved in that annual session. The report of the annual session (E/2011/45) notes as follows:

> *Article 9: Associated enterprises*
>
> 40. The main issue for the commentary on article 9 related to the wording in paragraph 3 of the 2001 version of the commentary expressing a recommendation by the former Group of Experts that countries should follow the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Transfer Pricing Guidelines) in applying the arm's-length principle. Paragraph 3 of the 2001 United Nations Model Convention provides:
>
> > With regard to transfer pricing of goods, technology, trademarks and services between associated enterprises and the methodologies which may be applied for determining correct prices where transfers have been made on other than arm's-length terms, the Contracting States will follow the OECD principles which are set out in the OECD Transfer Pricing Guidelines. These conclusions represent internationally agreed principles and the Group of Experts recommend[s] that the Guidelines should be followed for the application of the arm's-length principle which underlies the article.
>
> 41. Following discussion, it was agreed to retain the existing paragraph, which endorsed the arm's-length principle in determining transfer pricing issues implicit in article 9 and which recognized the role that the OECD Transfer Pricing Guidelines played in practice in applying the arm's-length principle. Most members considered that those views were still appropriate. Some members raised concerns, however, about the appropriateness of the views of the former Group of Experts as set out in paragraph 3 and questioned whether they were too broadly stated. In particular, the recommendation that countries should follow the OECD Guidelines might need to mention the fact that they were only for guidance in applying the arm's-length principle. Three members (Marcos Valadão, Tizhong Liao and Anita Kapur) had reservations on the views expressed by the former Group of Experts as stated in paragraph 3 of the commentary.
>
> 42. It was agreed to consider those issues further without prejudging the outcome of such consideration. In the meantime, paragraph 3 was amended to

clarify that the views expressed by the Group of Experts in the 2001 United Nations Model Convention had not been fully considered by the Committee, although there was unanimity among the Committee members that the arm's-length principle underlay article 9 of the United Nations Model Convention. The Committee noted that work was continuing on producing a manual on the practical aspects of transfer pricing, which would focus on the issues facing developing countries. The mandate for the Subcommittee charged with that work was reconfirmed. The Subcommittee was mandated to develop a practical manual on transfer pricing, based on the following principles:

(a) It should reflect the operation of article 9 of the United Nations Model Convention, and the arm's-length principle embodied in it, and be consistent with relevant commentaries of the United Nations Model Convention;

(b) It should reflect the realities for developing countries at the relevant stages of their capacity development;

(c) Special attention should be paid to the experience of other developing countries;

(d) It should draw upon the work being done in other forums.

43. In addition, it was confirmed that the work would continue in accordance with the understandings outlined in paragraph 48 of the report on the sixth session (E/2010/45), including that it would be consistent with the OECD Transfer Pricing Guidelines, to which the United Nations commentaries made reference.

44. In accordance with the results of the discussions as noted, it was agreed that the wording of paragraph 3 should be amended to read as follows (the new wording is in boldface type):

> With regard to transfer pricing of goods, technology, trademarks and services between associated enterprises and the methodologies which may be applied for determining correct prices where transfers have been made on other than arm's-length terms **the former Group of Experts stated that** the contracting States will follow the OECD principles, which are set out in the OECD Transfer Pricing Guidelines. **The former Group of Experts, in the United Nations Model Convention published in 2001, came to the view that** these conclusions represent internationally agreed principles and **it** recommend**ed** that the Guidelines should be followed for the application of the arm's-length principle which underlies the article.
>
> **The views expressed by the former Group of Experts have not yet been considered fully by the Committee of Experts, as indicated in the records of its annual sessions.**

Matters for consideration in relation to the commentary

6. As noted, the further consideration of paragraph 3 was in effect deferred until after the Manual was completed. Now that completion has been achieved, the issues for the Committee include:

(a) Whether the consideration should be confined to that of paragraph 3 or should include a broader review of the article 9 commentary;

(b) The priority that should be accorded to the present work and its particular elements;

(c) The relationship to work being conducted by other organizations and entities;

(d) Whether a subcommittee should be formed to consider the issues, and if so whether it should also be responsible for work on updating the Manual (considered below);

(e) The extent to which any such subcommittee should be asked in its mandate to consider certain issues, while leaving available the option for the subcommittee to recommend other such issues for consideration;

(f) The Coordinator for any such subcommittee (traditionally chosen from among members of the Committee, when possible);

(g) The extent to which the membership of any such subcommittee should be determined at the annual session, could be agreed upon later or could be left to the discretion of the Coordinator, bearing in mind the need for broad and balanced representation in practical terms;

(h) The need for different subcommittees to consult on issues that have obvious "cross-cutting" aspects.

Update of the Manual

7. The Manual was finalized at the eighth session in October 2012, subject to some minor editing. The Manual was officially launched on 29 May 2013 after completion of that editing. The Manual notes that some issues should be part of the next edition. Paragraph 6.3.5 provides examples of the application of the transactional net margin method, and footnote 60 to the paragraph reads:

> The examples below derive from the US Internal Revenue Service Intercompany Transfer Pricing Regulations. The Manual will include examples from developing countries in the next edition.

8. The need for more developing country examples is a general one, consistent with the mandate for the Manual that special attention should be paid to the experience of other developing countries.

9. Paragraph 6.1.2.7 gives only a brief discussion of intangibles, and footnote 53 to this discussion says:

> The Subcommittee discussed the possibility of preparing more detailed guidance on intangibles in a separate Chapter of this Manual, but was unable to complete the work in the time available. This item will be added to the programme of work with a view for completion for the next edition of the Manual.

10. Finally the Manual notes, at paragraph 8.2.2.8, in respect of capacity-building programmes in transfer pricing that:

> These programmes are many and varied in content but are essentially aimed at bringing international expertise and best practice to countries in need of developing and furthering their transfer pricing regimes. The next edition of this Manual is expected to include a list of available training resources and advice on accessing them.

11. The paper presented to the annual session for comment in 2012, entitled "Transfer pricing: technical assistance and capacity building resources" (E/C.18/2012/CRP.14) is a potential basis for such a chapter.

12. Another issue not addressed in any detail in the Manual, but where work has already been done in the subcommittee, is that of intra-group services.

13. In his final report for the Committee in October 2012 (E/C.18/2012/CRP.1), Stig Sollund, Coordinator of the Transfer Pricing Committee, touched upon some of those issues when he noted in paragraphs 6 to 8 that:

> It has become clear, however, that the Manual would benefit from further, more detailed, examination of issues such as the treatment of intangibles and services. Not all users of the Manual will seek such additional detail, but many will, reflecting the fact that developing countries are at many different stages on their respective transfer pricing "journeys".
>
> This further elaboration would represent a natural "Phase 2" of the Manual's life, rather than a current incompleteness, and the Committee may wish to consider providing the Subcommittee with a mandate to continue work on such more detailed examination of relevant issues, and on making proposals for the updating and continuous improvement of the Manual, with an initial view to putting forward proposals to the ninth annual session of the Committee in 2013. This will only improve the Manual's relevance to users and its significance as a work that can be relied upon in the capacity-building efforts of the United Nations and others that are so needed in this field.
>
> The Secretariat has also commissioned a report on training opportunities available in the area of Transfer Pricing. This will be made available to the Committee separately with a view to its being transformed into an Annex to the Manual.

14. In the report of its eighth annual session (E/2012/45, para. 20), the Committee noted that:

> Issues that could not be addressed at the present stage would be collected by Mr. Sollund until 30 June 2013 and included in a catalogue of items to be handed over to the new membership of the Committee for future discussion and possible inclusion in later editions.

15. That catalogue of items, which is not expected to be lengthy, will be available before the ninth annual session as document E/C.18/2013/CRP.15.

Matters for consideration in relation to the Manual

16. The matters for the Committee in relation to the updating of the Manual as a "living document" include:

(a) The priority that should be accorded to the present work and its particular elements;

(b) Whether a subcommittee should be formed to consider the issues, and if so whether it should also address the revision of the commentary on article 9 (considered above);

(c) The relationship to work being conducted by other organizations and entities;

(d) The extent to which any such subcommittee should be asked in its mandate to consider certain issues, while leaving available the option for the subcommittee to recommend other such issues for consideration;

(e) The Coordinator for any such subcommittee (traditionally chosen from among members of the Committee, when possible);

(f) The extent to which the membership of any such subcommittee should be determined at the annual session, or could be agreed upon later or could be left to the discretion of the Coordinator, bearing in mind the need for broad and balanced representation in practical terms;

(g) The need for different subcommittees to consult on issues that have obvious "cross-cutting" aspects.

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Committee of Experts on International Cooperation in Tax Matters
Ninth session
Geneva, 21-25 October 2013
Item 6 (b) (iii) of the provisional agenda*
Discussion of substantive issues related to international cooperation in tax matters: other issues: foreign direct investment issues and corporate taxation, including resource taxation issues for developing countries

Foreign direct investment issues and corporate taxation, including resource taxation: issues for consideration by the Committee

Note by the Secretariat**

Introduction

1. Foreign direct investment issues and corporate taxation, including resource taxation issues for developing countries, is on the agenda for the ninth session of the Committee of Experts on International Cooperation in Tax Matters under agenda item 6 (b) (iii).

2. At the seventh session, and with the latest update of the United Nations Model Tax Convention completed, the Committee decided that it would be useful to examine a series of issues through the presentation of papers at the eighth session. Robin Oliver (then a member of the Committee) was tasked with a presentation on foreign direct investment issues focusing on the relevance of economic rents in that context. The presentation drew in part on a note on the use of tax incentives to attract foreign direct investment (E/C.18/2010/CRP.13) that had been presented by Stefan van Parys of the University of Ghent, representing the World Bank Group at the sixth annual session of the Committee in 2010.

3. The presentation by Mr. Oliver considered how tax on foreign capital

* E/C.18/2013/1.

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negatively affects the volume of investment, resulting in lower wages and/or higher unemployment. Issues of location-specific economic rents and their relevance or otherwise to articles 5 and 7 of the United Nations Model Tax Convention on permanent establishment and business profits, article 6 on income from immovable property, article 9 on associated enterprises, article 10 on dividends, article 11 on interest and article 12 on royalties were discussed. Issues other than those related to the extractive industries are not addressed in the present note.

4. Following the presentation, the Committee discussed issues such as location-specific rents associated with natural resources and the need for appropriate tax policies for resource exploitation. According to a number of participants, many developing countries were losing out on such revenue. Those exploiting the resources were often provided with tax exemptions that could not be economically justified, while their activities led to externalities, for example environmental damage, that negatively affected local communities, which were often not appropriately compensated.

Expert meeting

5. With a view to assisting the Committee in addressing the agenda item, the Financing for Development Office of the Department of Economic and Social Affairs of the Secretariat organized a one-day expert group meeting on 28 May 2013.

6. The aim of the meeting was to (a) identify the pressing issues of developing countries in the area of taxation of the extractive industry; (b) determine the needs for guidance on those issues; (c) inform the work of the Committee on how it might make a unique contribution in the field while working constructively with others; and (d) bring together the different stakeholders involved in those issues.

7. The discussions focused on the issues that developing countries face when designing and administering an extractive industries fiscal regime with a view to ensuring that the United Nations tax cooperation work can further support developing countries in that important area of development. During the meeting, participants from national tax authorities, international organizations, non-governmental organizations and the private sector considered the question of international tax cooperation in the extractive industries sector, including institutional arrangements to promote such cooperation.

8. A detailed report of the meeting summarizing the presentations by participants and the ensuing discussions will be made available on the website of the Financing for Development Office (un.org/esa/ffd) before the ninth annual session.

Possible areas of engagement

Investment climate

9. The Committee may wish to discuss the importance of a conducive investment climate to encourage investment, which in turn can contribute to sustainable development. At the same time, the role of tax incentives can be scrutinized and the impact they may have on a country's revenue base, e.g., its ability to finance schools, hospitals and other public goods, can be assessed. Moreover, the

Committee might consider how a "race to the bottom" in the provision of tax incentives can be avoided, including by ensuring that any such incentives are properly designed, monitored for effectiveness and abuse and kept up to date. The need for a diversified economy and revenue base is also relevant in that respect.

Special features of the sector

10. The Committee might address the special features of the extractive industries, including the relevant differences between various types of extractive industries as well as features that are common to all of them, and what they potentially signify for a country's development path. That includes, but is not limited to, the revenue volatility from those industries, the difficulty of designing appropriate tax systems to tax economic rents, the need for transparency from the government and the private sector and the tax-related issues of dealing with negative environmental externalities.

Role of different actors

11. In their deliberations, the Committee will need to bear in mind the respective roles of different international organizations active in the area, including the International Monetary Fund, the World Bank and the Organization for Economic Cooperation and Development as well as regional and other organizations. The goal is to ensure that the United Nations tax cooperation work can further support developing countries in that important area of development (especially through cooperation between such countries) while avoiding unnecessary duplication and fragmentation but allowing for the possibility for developing countries to receive "second opinions" on issues of particular relevance to them.

12. Moreover, the Committee might consider it appropriate to explore the roles, rights and responsibilities of taxpayers, their advisers and non-governmental actors in that area.

13. The Committee might also examine how the taxation of the extractive industries relates to other topics currently under discussion in the Committee and other forums, such as transfer pricing, the taxation of services, the exchange of information and value-added taxes, as well as building institutional and administrative capacities.

Immediate issues

14. At the eighth session, it was decided that a working group would be formed to address the specific issues of natural resource extraction and tax revenue for developing countries. Given the limited time that such a working group would have had before it "expired" at the end of June 2013, such a group was not formed. The decision on the formation and mandate of such a group is now left to the new membership of the Committee.

15. Issues the Committee may wish to consider include the following:

(a) The priority that should be accorded to the present work and its particular elements;

(b) The expected deliverables (e.g., a policy and/or administration "toolkit" for developing countries, specific technical or administrative guidance and recommendations or other practical needs-driven measures of support);

(c) The mandate of the working group or subcommittee and which of those two forms it should take;

(d) The relationship to work being conducted by other organizations and entities, including aspects of the work related to the United Nations Model Tax Convention;

(e) The extent to which any such working group or subcommittee should be asked in their mandate to consider certain issues, while leaving available the option for that body to recommend other such issues for consideration;

(f) The Coordinator for any such working group or subcommittee (traditionally chosen from among Members of the Committee, when possible);

(g) The extent to which the membership of any such working group or subcommittee should be determined at the annual session, could be agreed upon later or could be left to the discretion of the Coordinator, bearing in mind the need for broad and balanced representation in practical terms;

(h) The need for different working groups or subcommittees to consult on issues that have obvious "cross-cutting" aspects.